

The end of QE2 by June end, horrified US jobs growth and burden of debt ceiling is paving the way for likely QE3! And hence a sumptuous period for the yellow metal is in the offing...

Recommendation

Sell at 1550-55 TP 1480-1450 SL above 1580.

Recap

The staggering rise of silver price waned as the CME has raised initial margin for silver within a quick succession from \$16200 to \$21600 (with effective from May 9, 2011). Speculators were bound to unwind their positions after this combative decision has been announced; silver got a big hit to start the month. Billionaire investor Paul Touradji sold all of its shares (173000) in the SPDR gold trust, valued at \$24 million as per the filing to the US Securities and Exchange Commission led gold to retreat. However, the Central banks of Mexico, Russia and Thailand have increased their gold reserves valued at \$6 billion after the dollar plunged to its two years lowest.

Imports of gold into China grew significantly. They have imported more than 200 tons of gold in the first four months this year while 245 tons was imported in 2010. China's investment demand for gold has doubled to 90.9 metric tons in the first quarter of the year, outpacing India's modest rise to 85.6 tons, which led China to account for 25% of gold investment demand, compared with India's 23%.

The auspicious occasion "Akshaya Tritiya" has infused buying spree among the investors after gold dropped 4.51% to Rs.21641 in the very first week, providing breather to spot buyers. Gold ETFs also recorded a total volume of 1.5 tons. E-gold sales on the Financial Technologies- promoted NSEL are expected to touch Rs.250 crore and E-silver sales at Rs.450 crore. Total gold holding under E-gold contracts has, therefore, surged to 89 tons in one year after the contract was launched on the last Akshaya Tritiya.

Economic Overview:

The Federal Reserve kept the borrowing rate unchanged at near zero and also planned to continue a separate reinvestment about \$17 billion a month in proceeds from its portfolio of mortgage securities to buy treasury debt. This should help keep rates low on mortgages and other consumer loans. The FOMC meeting minutes on May 18 showed no firm decisions rather told to need more discussions was needed to normalize policy; however, the committee's asset purchase program and the federal fund target rate were warranted.

On May 18, the Bank of England's meeting minutes said a majority of members concluded a rate hike wasn't warranted due to a lack of evidence that higher inflation expectations were becoming ingrained in wage and price decisions and skepticism over the underlying strength of the economy, which has been reflected as CPI accelerated. Also, the central bank means to up the size of its asset-purchase, or quantitative-easing program from 200 billion pounds to 250 billion pounds. Hence, the bank of England kept the benchmark rate at record low of 0.5% to stimulate the growth during the government's fiscal squeeze. The BOE has said that the inflation remains uncomfortably high as the officials raised their forecasts for consumer prices and cut their prediction for economic growth. ECB also kept its benchmark rate unchanged at 1.25%.

Higher than expected inflation in China spurred concern that the central bank will keep raising interest rate and to maintain a prudent monetary policy and hence China raised bank reserve requirements for the fifth time this year by 50 bps to a record 21 percent with effective from May 18, 2011 this year to restrain prices, underscoring the risk that tightening measures will cause a slowdown in growth momentum.

Japan's surprising contraction in GDP led the BOJ to refrain from adding stimulus after deciding to maintain a 30 trillion Yen credit program and a 10 trillion Yen asset purchase fund as main policy tools. Signs of a deteriorating economy put renewed pressure on the BOJ to provide additional stimulus after it stepped-up asset purchases and flooded money markets with cash in the wake of the March 11 temblor. Fitch cut its outlook on Japan's sovereign debt ratings, saying the cost of the March earthquake and tsunami and the still-unknown bill for the clean-up after the nuclear crisis would further strain the country's public finances.

ECB leaders and policy makers are clashing over how to prevent the currency's regional debt with central bankers after floating the prospect of extending maturities on Greek bonds. This implies the risk associated with bonds and sensitivity to interest rate will change. European finance minister endorsed a bailout for Portugal, and, reprofiling of the Greek bond maturities which may be a part of a package including sales of state assets and deeper spending cut may take place as last year's 110 billion Euro rescue failed to restore Greece to financial health.

Precious Metals Price Performance:

Both gold and silver retreated in the last month as the dollar index remained pretty volatile throughout the month.

The European debt crisis and uncertainties over the region made both the dollar and the Euro buoyant. Overall, dollar has gained 2.34 percent to pressurize the precious metals. Gold reduced 1.32 percent while at the very beginning of the month silver plunged more than 20 percent. The raise in speculative margin in quick succession by the CME led the speculators to unwind their positions which impacted harshly upon silver. It settled the month by losing 21.16 percent.

Exhibit 1: COMEX Gold vs. Dollar Index

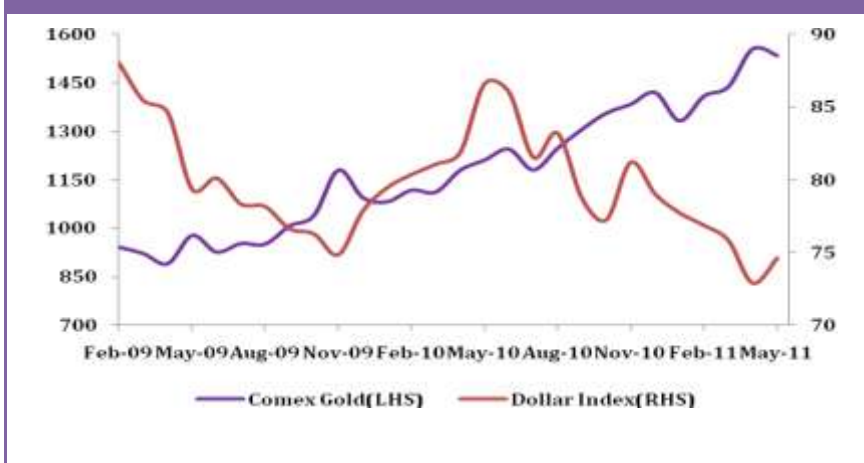
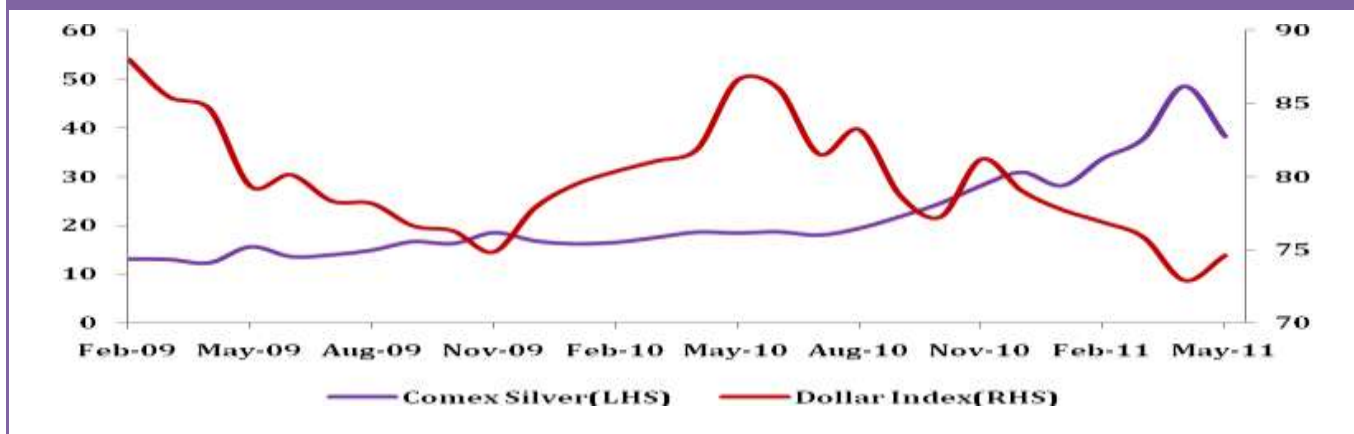


Exhibit 2: COMEX Silver vs. Dollar Index



Gold and silver in different currencies:

Except Pound, Euro and Kroner, gold has lost in terms of other currencies. Normally it moves inversely to the currency appreciation. Above mentioned currency has depreciated 2.78%, 1.55% and 2.15% respectively against the dollar which led gold to gain in terms of those currencies. Silver plummeted most in all currencies with respect to gold was mostly attributed to the speculative margin hike by the CME. So, irrespective of currency move against the dollar, silver plunged in terms of each currency. Precious metals and the Dollar Index usually share an inverse relationship, and last month was no exception of that. The dollar index gained 2.34% on the back of which both gold and silver retreated. Billionaire investor Paul Touradji sold all of its shares (173000) in the SPDR gold trust, valued at \$24 million as per the filing to the US Securities and Exchange

Exhibit 3: COMEX Gold vs. MCX Gold

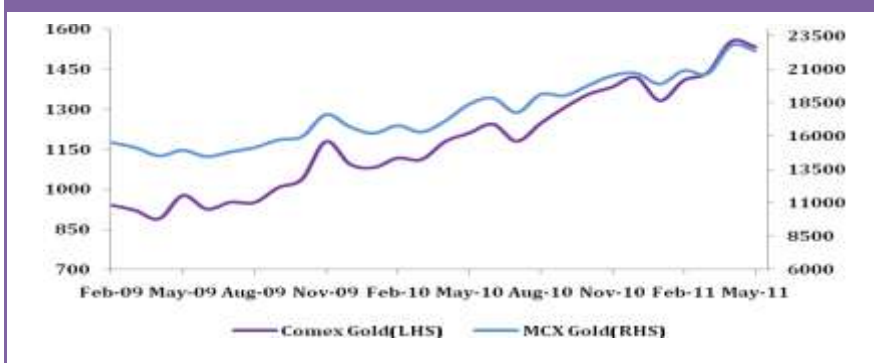
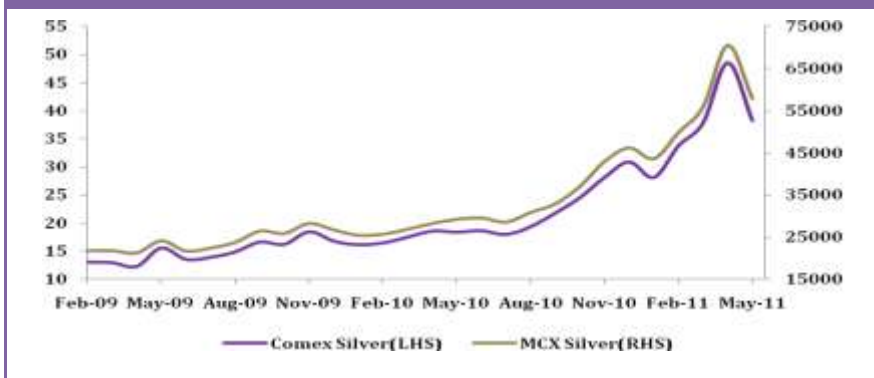


Exhibit 4: COMEX Silver vs. MCX Silver



Commission shattered investors sentiments to hold on to the metal was also another factor for the metal to retreat.

	Dollar	Rupee	Euro	Pound	Yen	Kroner	Franc
Gold	-1.32%	-1.73%	1.50%	0.24%	-0.92%	0.80%	-2.61%
Silver	-21.16%	-17.85%	-18.91%	-19.92%	-20.84%	-19.46%	-22.19%

Volatility

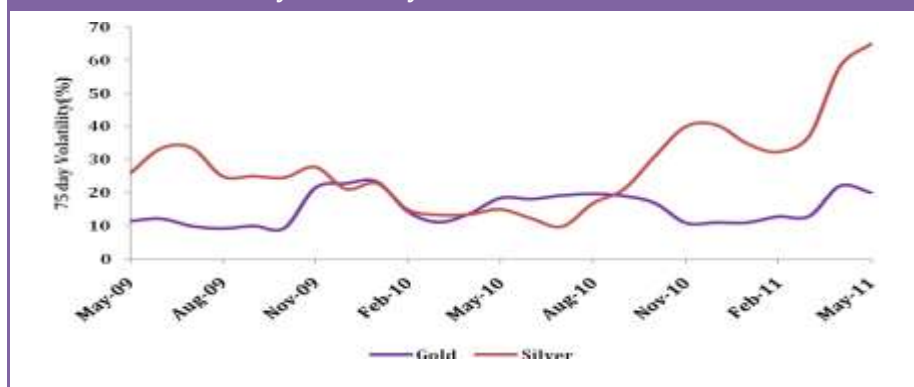
It is a measure of variation of price of a commodity over time. It does not indicate the direction of the movement, it is merely their dispersion. This is because when calculating standard deviation (or, variance) all differences are squared. Two commodities with different volatilities may have the same expected return, but the commodity with higher volatility will have larger

swings in values over a given period of time. For example, gold with lower volatility may have an expected (average) return of 7%, with annual volatility of 5%. This would indicate returns from approximately negative 3% to positive 17% most of the time (19 times out of 20, or 95% via a two standard deviation rule). Whereas silver with the same expected return

of 7% but with annual volatility of 20%, would indicate returns from approximately negative 33% to positive 47% most of the time (19 times out of 20, or 95%). These estimates assume a normal distribution.

Here we have taken 75-days volatility in to consideration for both gold and silver. It has been observed that silver's volatility remained always pretty high than gold. That is why in the month of April while silver had an outstanding performance with respect to gold; the month of May has seen exactly the opposite. The more the volatility, more is the risk.

Exhibit 5: MCX 75-days Volatility



Outlook

Gold has some things other going for it that other asset categories don't. For instance, the demand for equities is being driven primarily by the Fed's quantitative easing (QE2) program. In other words, it's a liquidity driven bull market for stocks and as long as the Fed is continuing to pump, investors basically have little to fear. When QE2 ends, however, there is some question as to whether the demand for stocks will continue or not. That's the time it will be achieving by the end of this month. Despite of buying \$600 billion bonds, the GDP growth and the unemployment level is still not at a right track. With debt ceiling hanging over the head, the Republicans are now not ready to increase the limit with out spending cut or increasing tax rate. Even if this happens, people will be having less disposable income to spend for, while a spending cut by the government will be raising concern about the GDP growth. A repercussion effects will be seen in the components of GDP, may it be government spending or expenditure or personal income. The Fed is also bind to keep its target interest rate to near zero level to foster the economic growth, can't even raise the deficit amount from raising interest rate which will be affecting corporate activities. So, the only out remaining is..."Launch of QE3". Printing of paper money will be accelerating the inflation only which will be a supportive factor for the bullion prices to grow.

Another problem that financial assets must contend with is what might be called the "domino effect." Since most financial assets these days are debt-based to some degree or another, they are highly vulnerable to downturns in the financial market. This is a common theme in every financial or economic crisis. The European countries, Japan even the US is suffering from this harm. Credit rating down gradation is going on every part of the world leading to fear factors among investors.

However, the global down fall in manufacturing activities may wave off the industrial demand component of silver. By the June end, as we discussed above, ending of QE2 may shift the investors' mentality from stocks and bonds to commodities like gold. This might impact on silver adversely. So, gold may remain strong for the month ahead while silver may remain bit volatile with high probability to lose some worth. Hence we expect the gold/silver ratio which stands at 40.12 at the month beginning, will improve. However, at higher prices profit booking may be seen which may lead a little correction.

The SPDR gold holdings came down by 1.5% last month (from 1229.64 tons to 1210.74 tons) while i-share silver holdings eroded almost 10% of its holdings (from 11021 tons to 9941.33 tons) raising concern about the investment demand for the metal. This again may fuel the silver price to fall at a faster pace than gold.

Technical Outlook



Prices made a new high of \$1577 initially but later on it came down till \$1462.10. However it settled after a smart rebound at \$1534.65 in comex gold august contract. This is symbolizing a short term pause in soaring prices of gold.

In monthly chart a **hanging man** candle stick pattern is witnessed which is considered as a top reversal pattern, signals that selling pressure is starting to increase. (*The low of the long lower shadow is indicating that the sellers pushed prices lower during the session. Even though the bulls are regaining their footing and drove prices higher by the end of the session, the appearance of this selling pressure after a rally is a serious warning signal.*)

Prices had been following a long term **trend channel pattern** and by looking at the chart we conclude that the buyers are getting exhausted after prices have touched \$1577. However, if the prices breached the given resistance of \$1577 and sustains above then it may trade up till the next resistance level of \$1630 (resistance level of the upper trend line of the said trend channel). Market is also trading far above the **short term EMA-8** (\$1450) signaling a slight correction in the prices. This number \$1450 is also a major support level as it is 23.6% retracement of the range \$1043-1577 as per **Fibonacci principle** and also a support level of **long term trend line** drawn by joining 4 significant troughs of 681.6-1043.75-1174.05-1324.6. **The momentum indicator RSI (14)** is trading at 0.72 declined after making a high of 0.75 (overbought mode) is indicating that the short term correction may be possible in the prices.

In the weekly chart a **bearish engulfing candle stick pattern** is witnessed which is also a trend reversal pattern. However, prices have **retraced 76.4%** after the pattern formation in the three consecutive bullish candle stick. But for this time a **high wave candle stick formation** is signifying that market may remain on the lower mode. Market is trading far above the **short term (EMA-8)** suggesting correction phase may be possible.

For the coming month we expect that the prices may remain slightly lower side and recommend selling.

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